

Improving corporate governance with functional diversity on FTSE 350 boards: directors' perspective

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Improving corporate governance with functional diversity on FTSE 350 boards: directors' perspective

Improving
corporate
governance

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Abstract

Purpose – Boards presently are considered the most critical component in improving corporate governance (CG). Board diversity is increasingly being recommended as a tool for enhancing firm performance. Academic research and regulatory action regarding board diversity are focussed mainly on gender and ethnic composition of boards. However, the perspective of board members on board diversity and its impact is mostly missing. Moreover, while strategic leadership perspective suggests that a broader set of upper echelon's characteristics may shape their actions, empirical evidence investigating the impact of less-explored attributes of diversity is almost non-existent. While the research on the input–output relationship between board diversity and firm performance remains equivocal, an intervening relationship between board diversity and board effectiveness needs to be understood. The purpose of this paper is to address all three limitations and explore the subject from board members' perspective.

Design/methodology/approach – The paper presents the findings of qualitative, exploratory research conducted by interviewing 42 board members of FTSE 350 companies. The data are analysed thematically.

Findings – The findings of the research suggest that board members of FTSE 350 companies consider the diversity of functional experience to be a critical requirement for boards' role-effectiveness. Functionally diverse boards manage external dependencies more effectively and challenge assumptions of the executive more efficiently, thus improving CG. The findings significantly contribute to the literature on board diversity, as well as to strategic leadership theory and other applicable theories. The research is conducted with a relatively small but elite and difficult to approach set of 42 board members of FTSE 350 companies.

Practical implications – The paper makes a unique and significant contribution to praxis by presenting the perspective of practitioners of CG – board members. The findings may encourage board nomination committees to seek board diversity beyond the gender and ethnic characteristics of directors. The findings may also be relevant for policy formulation, as they indicate that functionally diverse boards have improved effectiveness in a range of board roles.

Social implications – Board diversity is about building a board that accurately reflects the make-up of the population and stakeholders of the society where the company operates. The aim of board diversity is to cultivate a broad range of attributes and perspectives that reflects real-world demographics as boards need to continue to earn their “licence to operate in society” as organisations have a responsibility to multiple constituents and stakeholders, including the community and the wider society within which they exist. Building social capital through diversity has value in the wider context of modern society and achieving social justice.

Originality/value – The paper makes an original and unique contribution to strategic leadership theory by strengthening the argument of the theory. The paper explores beyond widely researched attributes of gender and ethnicity on boards and explores the impact of a less-researched characteristic of directors – their functional experience. Moreover, the paper opens the “black box” of CG – boards, and presents the



perspectives of board members. The findings indicate that board members in FTSE 350 boards define diversity more broadly than academics and regulatory agencies often do.

Keywords Board effectiveness, Corporate governance, FTSE 350 boards, Functional diversity on boards, Strategic leadership theory

Paper type Research paper

Introduction

Sound corporate governance (CG) facilitates long-term value creation for owners and other stakeholders (Randøy *et al.*, 2006). There are four prominent CG systems – Anglo-American, German, Latin and Japanese – which influence the legal, institutional and cultural mechanisms of stakeholders' control on companies and shape how corporations are run by the management (Oxelheim and Randøy, 2003). However, many countries adopt various other systems based on their customs and best interests (Rajharia and Sharma, 2014). CG regimes also influence legal systems, corporate structures and philosophies, political orientation and socio-economic and cultural practices (Goyal *et al.*, 2018).

The CG followed in the UK is an example Anglo-American system and is often referred to as being market-oriented, short-term-focussed and shareholder-centred (Palmer, 2011). The Anglo-American system of CG is also considered to be the most demanding in terms of extensive compliance/reporting procedures, and superior in terms of market performance (Oxelheim and Randøy, 2003; Useem, 1998). In the UK, listed corporations are governed by the UK CG Code (FRC, 2018, hereinafter referred to as “the Code, 2018”). The Code (2018) promotes the spirit of “comply or explain” – companies are expected to either comply with the provision of the Code or deviate from it but have to explain their reasons for doing so (Seidl *et al.*, 2013). However, while the Code (2018) does not mandate absolute adherence to its provisions, in practice, companies largely comply with the regulation (Arcot *et al.*, 2010).

CG practices have undergone momentous change since the late twentieth century (Hawkins, 1997) with enhanced regulatory scrutiny, and increased shareholder activism on account of numerous corporate failures and scandals in past decades (Bezemer *et al.*, 2012). Other changes that challenge the conventional style of CG, pertain to boards' voting patterns, use of innovative technologies, adoption of uniform global reporting standards and increased global competition (Garratt, 1997; Van der Walt and Ingley, 2003). One of the changes within the traditional CG system is related to the role of boards. Unlike in the 1970s and 1980s when boards were used by the management to seek occasional direction and leadership, boards are now accountable to their stakeholders (Kakabadse N.K. and Kakabadse A.P., 2007; John and Senbet, 1998; Rao and Tilt, 2016). Presently, boards are also more involved in decision making, more independent, and are under closer scrutiny (Burch, 2010; Golden and Zajac, 2001). At the apex of the internal control mechanism, boards play a central and critical role in making CG effective (Kakabadse N.K. and Kakabadse A.P., 2007; Kang *et al.*, 2007; Guest, 2008; Babić *et al.*, 2011). As a result, boards' role and their effectiveness are increasingly at the focus of CG research (Kipkirong Tarus and Aime, 2014).

A range of stakeholders of companies demand that boards be effective in their role-performance, such as institutional investors (Kesner and Johnson, 1990; Dalton *et al.*, 1998); employees, suppliers, customers (Hawkins, 1997); creditors, shareholders/shareholder activists (Daily *et al.*, 2003; Levrau and Van den Berghe, 2007), regulators (Huse *et al.*, 2011) and courts (Fairfax, 2011). Defined as their ability to perform their various roles successfully as a group (Thain and Leighton, 1992; Forbes and Milliken, 1999; Nicholson and Kiel, 2004; Babić *et al.*, 2011; Minichilli *et al.*, 2012; Knyazeva *et al.*, 2009), board effectiveness is observed to be a function of its composition (Terjesen *et al.*, 2009; Ferrero-Ferrero *et al.*, 2015). Academic research suggests that a board's effectiveness, and resultantly CG, may be influenced by board diversity (Thain and Leighton, 1992; Randøy *et al.*, 2006; Adams and

Ferreira, 2009; Rao and Tilt, 2016). Houle (1990) claims that a board's effectiveness may be a function of its ability to put its members' diversities to efficient use.

In this paper, we present the findings of a study conducted in FTSE 350 boards around the UK, investigating the role of board diversity in improving CG through its impact on their role-effectiveness. Having achieved voluntary targets of 25 per cent gender diversity on boards of FTSE 100 companies (Department for Business, Innovation and Skills, 2015, Women on Boards Review (also referred to as the Davies Review, 2015)), now FTSE 350 companies are under advisement to promote gender and ethnic diversity on their boards in a timebound manner (Parker, 2016; Hampton and Alexander, 2017). Hence, FTSE 350 boardrooms are an appropriate context for this research exploring how board members define diversity and perceive its role in CG. Currently in FTSE 350 boards, one of the more discussed and frequently reported attribute of diversity, gender diversity stands at 26.7 per cent (Hampton and Alexander, 2017). While a large body of academic research emphasises on increasing gender and ethnic diversity on boards, findings of this study indicate that board members define board diversity broadly. Board members consider diverse boards to be critical for the effective performance in a range of their roles and in dealing with dynamic governance environment of today. While the regulatory emphasis has been on improving gender and ethnic diversity (Whitehead and Normand's, 2011 Women on Boards Report (hereinafter referred to as the Davies Report (Whitehead and Normand, 2011)); Department for Business, Innovation and Skills, 2015; Davies Review, 2015; Parker, 2016), findings of this study suggest that a higher functional diversity may improve board effectiveness. The findings of the research also suggest that functional diversity on boards can be obtained by nominating people with diverse educational, industry-/sector-specific and role-specific experiences, which leads to an improved intellectual capital on boards. Such boards may manage external dependencies more effectively and may have a higher ability to challenge managerial assumptions.

The rest of the paper is structured as follows: we first review relevant literature on board effectiveness and attributes of effective boards. We then discuss the literature on board diversity, with reference to strategic leadership theory and the impact of board diversity on board effectiveness. We also articulate the research gap, pose the research question and describe the methodology adopted to seek the answer to them. Subsequently, we present the findings of this research, and discuss them with reference to existing academic literature. Finally, we conclude with discussing contributions and limitations of the study and make a few suggestions for future research.

Board roles and effectiveness

Primary roles of boards vary depending on CG regimes and contextual settings of boards (Ees and Postma, 2004), however, there is a broad consensus among scholars of CG that the monitoring role (Fama, 1980; Kim *et al.*, 2014), resource-provisioning role (Pfeffer and Salancik, 1978; Miller and del Carmen Triana, 2009) and service role (Mace, 1971; Pugliese *et al.*, 2014) are performed by most boards (Zahra and Pearce, 1989; Nicholson and Kiel, 2004; Pugliese *et al.*, 2014; Madhani, 2017). In the UK, the Code (2018) expects boards to provide entrepreneurial leadership: set strategy, values and standards for the company; ensure availability of resources; review management performance; and fulfil their obligations to their shareholders. The UK-based academic literature demarcates the roles within boards, and argues that mentoring and advising the executives is the responsibility of the chair (Bowen, 1994; Kakabadse A.P. and Kakabadse N.K., 2007), and monitoring the executives that of the non-executive directors (NEDs) (Vafeas and Theodorou, 1998).

Different theoretical perspectives govern the different primary roles of boards. The monitoring role of boards is shaped by agency theory, which posits that boards are shareholders' agents and are expected to control the executives' self-serving tendencies

(Fama, 1980). It is argued that boards that are independent of the CEO/executive will be effective in performing their monitoring tasks (Fama and Jensen, 1983a, b; Goyal and Park, 2002). The Code (2018), which governs listed companies in the UK, recommends boards appoint directors with the independence of “character and judgment” (p. 10, Clause B.1.1). Independence of mind and thinking enables board directors to constructively analyse and test executives’ proposals and assumptions (Van den Berghe and Baelden, 2005; Walker, 2009). It is suggested that the educational qualifications of directors may also equip them with independent thinking, crucial for boards’ effectiveness (Brown, 2005; Singh *et al.*, 2008). Currently, boards and board committees in many countries consist exclusively of independent directors, and such boards are likely to spend a considerably long time in monitoring the executive (Faleye *et al.*, 2011).

Stewardship theory (Donaldson, 1990; Donaldson and Davis, 1991), on the other hand, negates managerial opportunism and claims that the interests of the principals (shareholders) and the agents (managers/executives) are aligned (Huse, 2005). This theory does not put as much emphasis on the independence of directors and instead argues that independent directors may not be able to perform their roles adequately. Independent directors may lack access to crucial company-specific information (Adams, 2009; Faleye *et al.*, 2011). Instead, for effectiveness in this role, the board/directors require the knowledge and expertise in organisation-specific phenomena (Ruigrok *et al.*, 2007), and they need to apply their knowledge in the context of the firm (Forbes and Milliken, 1999; Kakabadse N.K. and Kakabadse A.P., 2007). Additionally, stewardship theory holds that the relationship between managers and principals is one that should operate on trust. Under stewardship theory, trust is the foundational structure and functional core (Mayer *et al.*, 1995). The board’s role is to support and facilitate management in accomplishing the firm’s goals. Coleman (1988) also argues that a high degree of trustworthiness among parties benefits both the executives’ and the firm’s performance.

The third theoretical perspective is the resource dependence theory of CG (Pfeffer and Salancik, 1978), which posits that boards are boundary spanners for firms (Aldrich and Herker, 1977). Associating this perspective with the social network perspective (Carpenter and Westphal, 2001; Westphal, 1999), boards become instruments of door-opening, legitimacy and networking, and managing companies’ dependence on external resources (Pfeffer and Salancik, 1978; Johnson *et al.*, 1996; Huse, 2005). Kesner (1988) suggests that board members are expected to provide resources to the organisation and, hence, candidates with better human capital may have a higher likelihood of being considered for board positions. Board members’ reputation, knowledge and networks may improve their role-effectiveness on boards (Johnson *et al.*, 2013). Board members are also expected to provide relational resources to the firm, including critical occupational networks: access to the bankers and political players, suppliers, buyers and public policy decision makers (Hillman and Dalziel, 2003; Ferreira *et al.*, 2010; Hillman *et al.*, 2000; Baysinger and Butler, 1985). Resourceful and well-networked board members ensure that their boards’ reputation for probity and efficiency is not tainted, thus improving boards’ effectiveness in a variety of roles (DeMott, 2010).

Nicholson and Kiel (2004) articulate boards’ resourcefulness as its capital – human, social/relational and cultural, and suggest that board capital may impact boards’ effectiveness. Human capital theory (Becker, 1964) proposes that organisations benefit from an individual’s cumulative cognitive and productive capabilities such as their education, skills and experience (Terjesen *et al.*, 2009). The firm may also benefit from the directors’ intellectual resources such as varied experience (Treichler, 1995), reputation and legitimacy (Pfeffer and Salancik, 1978; Zahra and Pearce, 1989; Hillman *et al.*, 2000; Erakovic and Goel, 2008) and occupational attributes (Baysinger and Butler, 1985). As a result, it is argued that board capital obtained through board members’ status, prestige and reputation may send a

positive signal to stakeholders of the company that the company is led by capable members (Certo, 2003).

Boards of listed companies in the UK are mostly unitary, that is, they have a single tier and have executive and non-executive members serving boards alongside each other (ACCA Global, 2012). This is different from board structures in various other European countries where boards are two-tier and have a separation of functions – supervision and operations. In the UK, listed companies' chairs lead boards and CEOs lead the executive top teams; however, CEOs are also members of the board.

While existing literature seems to broadly define board diversity, empirical research is skewed in its focus on the gender and ethnic composition of boards (e.g. Broome and Krawiec, 2008; Miller and del Carmen Triana, 2009; Harjoto *et al.*, 2018). Presented below is a brief review of board diversity research, which highlights the research gap further.

Board diversity

Board diversity refers to the distribution of different attributes and characteristics among directors, which impact attitudes and opinions, and variations in the way boards are composed (Van der Walt and Ingle, 2003; Ararat *et al.*, 2010; Kang *et al.*, 2007). Various dimensions of heterogeneity of board members can be gender, age, nationality, functional background, skills, religion, political preference and sexual orientation among board members (Rao and Tilt, 2016). Board directors' attributes are grouped in different categories by different academics, such as observable diversity attributes (e.g. gender, age and race/ethnicity), and less observable attributes, e.g. education, previous work experience and competencies (e.g. Kang *et al.*, 2007; Galia and Zenou, 2013; Rao and Tilt, 2016; Milliken and Martins, 1996; Forbes and Milliken, 1999); structural (board size, leadership structure, the ratio of national/international directors and board independence) and demographic diversity (Hafsi and Turgut, 2013); and surface level/deep level (Harvey, 2013). Board diversity is also studied with reference to heterogeneity of board directors' tasks and relations (Joshi and Roh, 2009), "Task-related" diversity refers to department or unit membership, former credentials or tenure, their knowledge, skills, abilities – both cognitive and physical; and "relation-oriented" diversity relates to their network, membership of religious or political groups, their social status, attitudes, values, personality and behavioural styles (Jackson *et al.*, 1995). At last, board diversity is also defined with reference to a board's demographic, and human and social capital. Demographic attributes of directors include age, education, ethnicity/race and gender. Human capital refers to their functional experience, role and tenure. Social capital comprises their professional networks – interlocks, personal relationships and status, prestige and membership of elite organisations/institutes (Johnson *et al.*, 2013).

For boards, the issue of diversity is a relatively new one, as until the 1970s organisations preferred the status quo and opposed the inclusion on boards of people with different attributes (Houle, 1990). Presently, board diversity is considered as one of the significant dimensions of an effective board structure (Van den Berghe and Levrau, 2004). Diverse boards are considered more effective in their role-performance (Randøy *et al.*, 2006) and are recommended by a range of external and internal stakeholders of companies. Research reports that governance practitioners, pension funds creditors, shareholders/shareholder activists, other investors, customers, employees, legislative authorities, regulators and courts favour diverse boards (Anderson *et al.*, 2011; Huse *et al.*, 2011). CG scholars also suggest that board diversity may play a role in improving monitoring and control of the executives (Ferreira *et al.*, 2010), enriching board interactions and improving board processes (Milliken and Martins, 1996).

The UK's CG has been a trend setter on board diversity, with the Higgs' (2003) review and Tyson's (2003) report recommending that boards have a more open recruitment process

for director nominations and appoint NEDs from a diverse pool. The Code (2018) also recommends that boards nominate NEDs from a wider talent pool and promote diversity on boards. In the UK, regulatory agencies encourage top public listed companies to improve gender diversity on their boards (the Code, 2018). In the recent past, FTSE 100/350 companies have been encouraged to voluntarily assign and achieve targets for improving gender/ethnic diversity on boards (Whitehead and Normand 2011; Davies Review, 2015; Parker, 2016; Hampton and Alexander, 2017). The UK CG regime supports board diversity as a business case and suggests that diverse boards will lead to an improved corporate performance (the Code, 2018). Practitioners reports such as Spencer Stuart (2018) Board Index, Board Diversity Tracker (Egon Zehnder, 2018) report, Grant Thornton (2018) CG Review, Cranfield University/BIS reports regularly review the status of board diversity in FTSE companies. However, before this empirical enquiry on board diversity and its impact on board effectiveness is further explained, presented in the next section is the theoretical foundation of this relationship – strategic leadership theory (Finkelstein *et al.*, 2009).

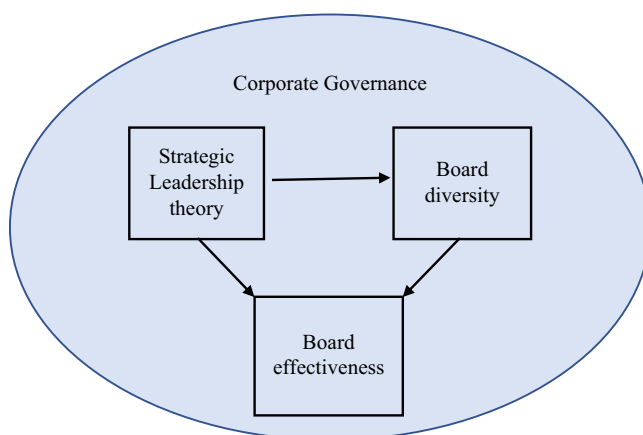
Strategic leadership theory and board diversity

This study aims to explore beyond limited diversity attributes of gender and ethnicity, and is hence guided by strategic leadership perspective, which posits that decisions taken in organisations are the product of decision makers' characteristics and their interpretations of situations (Hambrick and Mason, 1984). These interpretations and characteristics in turn may be influenced by the experiences, education, functional background, values, social connections and other human aspects of the decision makers, which regulate their cognitive information processing (Finkelstein and Hambrick, 1990; Cannella and Monroe, 1997). The essence of this theory is that leaders often have to make strategic decisions in complex and ambiguous situations, exercising their discretion, which is shaped by their characteristics (Finkelstein and Hambrick, 1990). It also posits that top executives' values, cognitions and personalities may also impact their field of vision as well as their perception/interpretation of information (Cannella and Monroe, 1997). The impact of strategic leadership attributes of top management executives (e.g. their leadership style) on firm outcomes is commented on in existing literature (Daily *et al.*, 2003; Vera and Crossan, 2004; Bear *et al.*, 2010; Galia and Zenou, 2013). Academics highlight the need to explore and understand the impact the different experiences of corporate leaders have on their actions and decisions (e.g. Finkelstein *et al.*, 2009, p. 69; Buyl *et al.*, 2011). Finkelstein *et al.* (2009) broaden the definition of upper echelon more than other studies have, and acknowledge the unique position of boards in the strategic decision-making process. The relationship between board diversity, effectiveness, strategic leadership perspective and CG, as conceptualised for this research, based on the review of existing relevant literature is presented in Figure 1.

As shown in Figure 1, this research explores the impact of board diversity on board effectiveness for enhancing CG, while defining board diversity through the lens of strategic leadership theory (Finkelstein *et al.*, 2009). Strategic leadership perspective defines the breadth of diversity on boards and indicates a relationship between board members' attributes and their decisions and actions, which are likely to influence board effectiveness. Board effectiveness is known to impact governance of companies in terms of their strategic decision making, protection of shareholder wealth and firm performance.

However, a literature review indicates that although board diversity is conceptually broadly defined, empirical research on the subject is largely limited to exploring the effect of a board's gender and ethnic composition on firm performance. A few other limitations of the existing literature on board diversity are now presented.

First, a large body of existing academic research on board diversity explores an input–output relationship between boards' demographical statistics and firms'



Source: Goyal (2018)

Figure 1.
Strategic leadership
theory, board
diversity and board
effectiveness

performance-related parameters (Johnson *et al.*, 1996; Pettigrew, 1992; Zahra and Pearce, 1989; Gabrielsson and Huse, 2004; Galbreath, 2018; Atif *et al.*, 2019). Academic research often measures boards' diversity attributes with regard to their impact on financial indicators of the firm (e.g. Carter *et al.*, 2007, 2010; Erhardt *et al.*, 2003; Nguyen and Faff, 2007). However, the relationship between board composition and firm performance may be a distant one and challenging to explore (Johnson *et al.*, 1996). Academic studies exploring input–output relationships may have overlooked the impact of board composition on an intermediary and critical component of board effectiveness (Gabrielsson and Huse, 2004; Nielsen and Huse, 2010).

Second, although the volume of research on board diversity is ever-increasing, a significantly large section of existing knowledge on the topic is focussed on the gender composition of boards (e.g. Harrison *et al.*, 1998; Bell, 2007; Nielsen and Huse, 2010; Chen *et al.*, 2016; Kumar and Zattoni, 2016; Atif *et al.*, 2019; Brieger *et al.*, 2019). The singular focus on gender may be essentialist as it masks diversity among women (Torchia *et al.*, 2015). Scholars suggest that while gender is a crucial aspect of diversity, other attributes, such as culture, education, professional background and age may also be relevant (e.g. Adams and Borsellino, 2015). Many other characteristics, such as skills, personality, beliefs and values of members that may influence the decision-making process in a group, are yet to be adequately explored (Harrison *et al.*, 1998; Milliken and Martins, 1996; Joshi and Roh, 2009; Bell, 2007; Torchia *et al.*, 2011; Kramer and Ben-Ner, 2015). Hence, more substantive diversity constructs need to be explored because the assumption of demographic attributes being valid proxies of leaders' thinking and perspective is questionable (Dhir, 2009). Scholars suggest that corporate leaders may need a variety of behavioural traits such as cognitive and social intelligence to be effective. They argue that cognitively complex individuals are better equipped to process information and conduct tasks (Boal and Hooijberg, 2001).

Third, in existing research on board diversity, readily available data from secondary sources, such as annual reports and statistical methods of analysis have often been used for exploring the relation between board composition and output of firm performance (Gabrielsson and Huse, 2004; Johnson *et al.*, 1996). It is argued that qualitative inquiries and intrusive measures of research may be more reliable in exploring boardroom behaviour and decision making (Hillman, 2015). To understand and explain the relationships, the researcher needs to collect data from proximity to the subjects researched and has anecdotes

to support them (Mintzberg, 1979). Moreover, existing board diversity research seldom explores views of board directors on the subject, with a few exceptions, such as Broome *et al.* (2011), Kakabadse *et al.* (2015), Goyal *et al.* (2018, 2019) and Kakabadse *et al.* (2018). The lack of understanding about board members' perspectives is due to their inaccessibility to researchers; however, it is crucial to the furthering of research in this area that board directors' views are gleaned, as they may be uniquely positioned to know the impact of diversity on the effectiveness of boards. Hence, this research explores the impact of board members' perspective on board effectiveness. Figure 1 presents the conceptual framework of the study.

The research presented in this paper endeavours to address all three limitations of the existing literature on board diversity, as presented above. Data were collected via face-to-face interviews with CG practitioners, board members of FTSE 350 companies. Participants in the study share their definition of board diversity and its impact on boards' role-performance/effectiveness. The paper now describes the method of data collection and analysis as adopted in this study.

The study

The study is conducted by collecting the data with the help of 42 elite interviews with chairs, CEOs, executive directors and NEDs of FTSE 350 companies. Difficulties in accessing board members for academic research are well recorded (Zahra and Pearce, 1989; Pettigrew, 1992). Board directors tend to be reluctant to associate themselves with individuals or projects that are not recommended by someone they trust (Broome *et al.*, 2011). An overwhelming dependence on secondary sources is due to the challenge of accessing the company "black box" for the purpose of academic research (Leblanc and Schwartz, 2007; Zona and Zattoni, 2007). Daily *et al.* (2003) argue that the fortress of boards, as they are perceived in academic studies, needs to be demolished in order to understand their governance. The secrecy surrounding board processes and interactions and the reluctance of corporate elites to share privileged information with researchers and other outsiders have earned boards the moniker of "black box" (Hambrick, 2007; Leblanc and Schwartz, 2007; Zona and Zattoni, 2007; Pettigrew, 1992; Kakabadse *et al.*, 2006; Torchia *et al.*, 2015). However, in order to understand board directors' perspectives on the subject it is imperative to interact with them because there are not reliable proxies for ascertaining their deeply held views. A questionnaire-based survey with a larger sample set would have provided the study with more measurable and generalisable findings; however, at this stage it is critical to first ascertain the constructs that can later be measured. Hence, elite interviews (Kakabadse *et al.*, 2012; Tansey, 2007; Kezar, 2003) are an appropriate and feasible method of data collection in the study.

The respondents in the study have diverse demographic attributes – ten ethnicities, four nationalities, mixed genders (26 male and 16 female participants), a broad age range (44–76 years), varied socio-economic-cultural backgrounds and diverse functional experience. Members have different functional backgrounds, such as finance, law, operations, HR and academia. Participants were initially approached from the personal networks of the authors via e-mail and, then, more participants were contacted at various networking events attended by the authors. A few participants introduced the authors to other board leaders in their network. Thus, the method of approaching participants for this study is purposive and snowballing (Tansey, 2007). As also carried out in several existing academic studies (e.g. Vasiliou and Adams, 2018), we adopted purposive and chain referral strategies to select participants for this research. The purposiveness of participants – having the experience of being a present/former board member, executive or non-executive, of at least one FTSE 350 company – is maintained during data collection. Participation of board members was voluntary and without any incentives.

The purposiveness of the sample set (Tongco, 2007), as determined for the first set, is maintained throughout.

The authors refrained from mentioning any specific type of board diversity (i.e. gender, ethnicity and nationality) and carefully avoided using any academic terminology for board effectiveness. Technical terms such as monitoring ability, service role or resource dependency/provisioning are deliberately avoided in the conversation in order to glean participants' definitions of and perceptions on these constructs. Participants are interviewed for 60–90 min each at their workplace (mostly their boardrooms and occasionally in their private offices) and interviews are tape-recorded with their explicit permission. The participants are assured of complete anonymity and confidentiality of their responses. This is done in order to ensure that participants are comfortable in sharing their views, as recommended in existing literature (e.g. Kezar, 2003). The extent of the use of data and the timeline of its preservation is also explained to them. Interviews had a “reflexive and flexible” approach allowing the participants time to reflect on questions (Seierstad, 2016, p. 396). This approach was adopted to glean additional information and personal experiences from them. A semi-structured and evolving interview protocol (Myers, 2013) was adopted where authors posed open-ended questions to informants based on the broad theme of gender-based discrimination in boardrooms. As recommended by scholars, a few open-ended and theme-based questions were posed to participants, where subsequent questions are posed and framed based on their response to initial questions; hence, although questions sometimes varied for different participants, the themes of inquiry remained the same. The initial questions are on the background of the participants and were followed by the main research-related themes: how they define board diversity; what they think are the critical roles performed by boards; whether board diversity plays a part in helping boards perform their roles; and how board diversity influences boards' ability to perform their critical roles. Participants who acknowledged the role of board diversity in improving board performance are requested to substantiate their claim with evidence or further explanation. The language of the questions was kept informal and non-academic; however, with board diversity being a familiar construct in CG in the UK presently, participants often demonstrated familiarity with the latest developments on the subject, such as the “mandatory quota vs voluntary target” debate and discussion around the government's idea of employee representation on boards.

The recorded interviews are then transcribed verbatim. Transcribed data are then disaggregated into conceptual units of a similar nature, which are given labels as recommended by Saunders *et al.* (2009). Data are then coded and thematically analysed (Baumgartner and Schneider, 2010; Braun and Clarke, 2006; Saunders *et al.*, 2009) individually, and the authors congregated to exchange notes and to ascertain themes that emerged from the data. The thematic analysis method was chosen, as it provides a deeper understanding of a phenomenon, which is sought to be interpreted by the people living and experiencing that phenomenon (Shah and Corley, 2006). Coding and analysis are performed manually and without the help of any electronic software. The thematic analysis involves identifying themes, and analysis is linked to the respondents or the contributors (Spencer *et al.*, 2003). Following transcript analysis, categories and theories emerged from the data (Snape *et al.*, 2003). First, using MS Word, the recorded data are arranged in tables, with rows for each of the interviewer's question and a separate row for each participant's response. Afterwards, more columns to this table are added for axial and select coding. Open coding is done by highlighting sections of transcribed text, which form the base for axial coding, which is conducted using words/phrases from reviewed literature and also new codes created by the authors. Finally, select coding is carried out by grouping axial coding of a similar nature. More data were collected until the data were saturated, and the authors convinced that further collection would not improve/add value to the findings

(Blaikie, 2009). As a result of the analysis of the study three themes emerged – relevant attributes/experiences of directors which have a bearing on their perspective; attributes/experiences which shape their actions/decisions and actual impact on boards’ effectiveness. In this paper two of these themes are being discussed in the interest of parsimony. The next section presents the findings of the study.

Findings of the study

The participants in the study claim that one of the significant aspects of board diversity, which often gets overshadowed by the discussion on gender and ethnic diversity, is the diversity of functional experience on boards. Functional experience of roles performed and the industry in which board members are engaged professionally influence board members’ perspective, actions, ability to contribute in boards, and as a result, board effectiveness. Three main themes emerge through the analyse of the data: the diversity of functional experience on boards leads to richer intellectual capital; functional diversity on boards helps boards in managing external dependencies; it also improves boards’ ability to challenge assumptions. An elaborate discussion of all three main themes with the help of supporting quotes from respondents in the study and existing literature on the subject is presented next.

Improved skill-set and richer intellectual capital

Participants in the study claim that board members with diverse functional experience such as industry and roles have a diverse thinking style and ability to contribute to boards. The participants suggest that while composing the boards, care needs to be taken to include all critical skill-sets specific to the requirement of boards. With regard to defining board diversity, several participants interpret board diversity mainly with reference to the range of functional experiences of directors, which may help boards in dealing with contingencies. One participant explains:

Diversity means people with diverse skill-sets. You can have an accountant, a lawyer, in the healthcare sector, people who understand the business. So, when you have a problem, they help you. (Resp. A)

Participants in the study claim that a varied professional experience leads to an enhanced intellectual capital on boards. Directors’ functional experience in a range of professional fields adds to their cognitive prowess, which improves their intellectual capabilities. The participants further explain that a higher education/vocational training enables board members to have intellectual capital, which broadens board members’ perspectives:

I believe in intellectual capital. Whatever is your learning, it is going to play some role. It may be just building up proficiency or your competency or your common sense. It colours your thinking. (Resp. B)

The participants in the study acknowledge that often boards are composed of disproportionate representation of members with expertise in finance-related matters. A diverse skill-set derived from a variety of professional experiences may be valuable assets for boards today. Participants suggest that functional competencies are the most significant component of an effective board. The diversity of functional experience equips a board with oversight and the ability to handle any eventuality. The set of skills relevant to boards may vary with the requirement of the board and the sector in which the company operates:

I believe in intellectual capital. Whatever is your learning, it is going to play some role. It may be just building up your skill base or proficiency or your competency or your common sense. It colours your thinking. Effective boards have people with different skill-sets and a range of experiences. [It helps] the direction of the business that could lead to better outrun performance because you

have got a different range of skill-sets. One thing that has been legislated in the United States is that people serving on your audit committee have to have finance and audit background. That is a functional question, but you have to have such competencies on boards. (Resp. C)

In the existing literature, compared to other surface-level characteristics of gender and ethnicity, research on the diversity of background is extremely limited (Mahadeo *et al.*, 2012). However, a limited body of literature on functional diversity on boards suggests that having a range of industry and sector experience on boards helps directors to contribute on a variety of issues (Nguyen *et al.*, 2015).

In a study conducted by top management teams in 66 US telecommunications firms, Olson *et al.* (2006) find that characteristics such as functional background can be acceptable proxies/indicators of psychological factors such as values and thinking style. Members with varied functional/occupational experiences may bring a different perspective (Pfeffer, 1983). Functional experience of top managers may shape their thinking style and thus, their strategic decisions (Jensen and Zajac, 2004). Studies posit that in decision making on a strategic matter, both the length of tenure and type of work are relevant experiences that impact individuals' thinking styles (Finkelstein and Hambrick, 1990; Jensen and Zajac, 2004; Hitt and Tyler, 1991).

Strategic leadership perspective, which was developed from the earlier upper echelon perspective, suggests that functional experiences influence the perspective and cognitive style of decision makers (Hambrick and Mason, 1984). Certain professional experiences can be more relevant to decision making in boards such as law and business (Forbes and Milliken, 1999). Leadership literature mentions that educational qualifications improves a leader's knowledge base (Hitt and Tyler, 1991) and their decision-making ability (Hitt and Barr, 1989). A limited body of academic literature on boards suggests that directors with a range of educational qualification and abilities may process differently the information presented before boards (Kipkirong Tarus and Aime, 2014). In this study, although an overwhelming majority of participants have several professional qualifications, two participants have no university education and yet have long board experience including that of leading boards (a chair) and leading top management teams (a CEO). The findings of the study do not suggest evidence of board members' level of educational qualification having a mentionable impact on board effectiveness. The participants acknowledge that all experiences, including educational qualification, obtaining education abroad and working abroad shape board members' perspective and their decision making. However, none of the participants suggested a direct influence of educational qualification on any specific role-performance of boards. The absence of evidence of the impact of educational expertise may indicate that while the same may have relevance for function-specific, top/senior management roles, such an experience may not have a direct bearing in board effectiveness. Simons *et al.* (1999) examine the effects of four types of demographic diversity on firm performance: functional background, education, tenure and age. They argue that functional, educational and tenure diversity be more job-related and refer to experiences, information and perspectives relevant to cognitive tasks (Simons *et al.*, 1999, p. 663). Their results indicate that diversity is beneficial for corporate decision making, but only when the diversity is task related and used to increase debate (Simons *et al.*, 1999). The findings of this research support the contention presented in existing knowledge and further extend the application to boardrooms and their effectiveness.

Thus, the findings of the study support the proposition of strategic leadership theory, which suggests that board members' functional experience may influence their interpretation of information presented to them. Findings of this research also contribute to the theory by indicating that there may be an intervening impact of such a diversity at an intermediary level of board effectiveness. Any impact of board diversity on firm performance, which, though suggested by strategic leadership perspective, is beyond the remit of this paper and hence not discussed here.

Workgroup literature on diversity claims that diverse functional experience is enhanced by cross-cultural exposure and learning about processes that result in a healthy conflict and an exploration of diverse views (Ely and Thomas, 2001). It is also claimed that corporate elite, having similar functional experiences, often take similar positions on business problems as they share a common perspective (Jensen and Zajac, 2004). Hence, introducing a range of functional backgrounds will enable the board to have a diverse perspective, thus ridding the board of groupthink. Our respondents in the study not only support the notion, but take it further, claiming that board members with diverse functional experience often demonstrate a different perspective in boardrooms, which improves boards' role-effectiveness collectively. Diverse functional competencies are considered to be the most significant component of an effective board. The findings further strengthen the suggestion of strategic leadership theory that experiences, values and backgrounds of corporate leaders (board directors and top executives) influence their actions and decisions. The findings in the study show evidence of functional experience being critical for board effectiveness in FTSE 350 companies.

Managing external dependencies

With reference to the role of boards' functional diversity and its impact on boards role-effectiveness, participants claim that board members with diverse functional experience may improve boards' professional network with significant stakeholders. One participant explains that board members are often appointed for their skill-set and networks they bring with their functional experience:

There is generally someone [on our board] who has connections to government – politicians, diplomats. These people add value through their networks, not necessarily through their competencies. People with networks across the industry. There are also people from various professional backgrounds. (Resp. D)

The participants in the study acknowledge that it is a board's responsibility to manage dependencies and, hence, members with a range of professional experience help boards in performing that role. When interpreted in academic vocabulary, it can be argued that the diversity of functional experience on boards improves their resource-provisioning effectiveness. Another participant who is CEO of a company that deals with equipment for armed forces explains that on his board, colleagues with background in public services and diplomatic services have a critical role to play in:

What we sell is the technology that is used in the defence equipment. Which means that our customer base is defence manufacturers or users. So, we need to have the influence [on customer], we still need to have those relationships. We maintain very good contacts with the high commissions. (Resp. E)

Existing literature also suggests that functional diversity on boards provides them with access to different networks. Such networks are developed by members while working in other companies, thus improving boards' resource dependency role-effectiveness (Anderson *et al.*, 2011; Nguyen *et al.*, 2015). Directors with the experience of other industries may help the boards to identify entrepreneurial opportunities in newer markets (Kim and Rasheed, 2014). Hambrick and Mason (1984) claim that the level and type of functional engagement determines individuals' reactions and orientation to their environments. In this study, the participants indicate that functional diversity on boards improves board capital (intellectual and relational) and that boards appoint directors for their networks and access to external resources as well.

Improved ability to challenge assumptions

Participants in the study claim that the main impact of diverse boards with a variety of skills-sets is their ability to question the executive and challenge their assumptions on strategic matters. A diverse perspective acquired through diverse functional experience

improves boards' monitoring effectiveness. Moreover, boards presently are expected to have skill-sets in innovative areas, such as cybersecurity and digital strategy, and a wide range of thinking styles, such as deductive-thinkers, intuitive thinkers, visionaries and pragmatists:

If you have somebody who understands technology, which is a big driver these days for corporations, they are able to challenge some assumptions. If you have a person with a deep insight into human management, human relations, and human resources, the board has another competency around the table. I think many boards are too full of finance backgrounds. So, they focus only on a small set, the numbers, and not get behind the numbers. (Resp. F)

Professional experience in relevant fields, such as industry-specific knowledge, expertise in finance, HR, operations, the experience of managing operations abroad or experience in the public sector may be critical for decision making in boards. Different types of experience such as those gained from industry, roles and having a range of competencies may be valuable for improving effectiveness of boards. One participant articulates:

I think it is important to have people who know the business area and the industries that they serve and have the technical experience to know what the issues are likely to be and the relationship between businesses, their customers and their supply chain. (Resp. G)

Participants further assert that many other skills, which were not valued conventionally, have gathered significance for boards' ability to supervise the executive more effectively. Due to developments in technology, boards composed without expertise in technological matters may compromise their monitoring effectiveness. As a result, the varied experiences, backgrounds and skills of the directors may help the boards improve their monitoring effectiveness (Anderson *et al.*, 2011). Thus, the findings of the study support the existing literature and indicate that a larger skill-set on boards improves their ability to scrutinise and probe, and hence monitor more effectively.

Thus, a range of functional expertise and experience improves the role-effectiveness of board members in multiple board roles. This diversity attribute was claimed by the participants in the study to be the most significant aspect for improving boards' decision making and performance. Group-diversity-based literature suggests that minority members in boards may stimulate divergent thinking and offer unique perspectives, which can alter the outcomes (Westphal and Milton, 2000). It is also indicated that functionally diverse board members may bring "diverse perspectives, talents, and problem-solving skills to corporate deliberations" (Anderson *et al.*, 2011, p. 9). Such board members also may alter the orientation of opinions and strategic action (Golden and Zajac, 2001). The findings of this research support several of these suggestions in the existing literature and articulate specific board roles that benefit from functional diversity on boards.

Discussion

Conversation around board diversity is becoming louder in the UK CG scene, strengthened by an overwhelmingly large body of academic research, active support by business schools (e.g. Henley Business School) and board search companies (e.g. Heidrick and Struggles), which are offering to support female aspirants to board positions; and the various periodical reviews (Grant Thornton, Spencer Stuart Board Index and Egon Zehnder to name a few) of the status of diversity on boards. However, findings of this study observe that while the emphasis of regulatory authorities has been on promoting gender and ethnic diversity, boards need to explore other attributes of diversity for higher role-effectiveness. Diverse functional experience of board members adds value to boards' effectiveness by improving their monitoring and resource-provisioning role performance, through improving boards' collective intellectual capital with an improved skill-set. Boards with diverse functional experience, obtained through professional experience in

diverse sectors, roles and industries, enable board members to challenge assumptions and manage external dependencies more effectively.

Several participants explain that only functionally diverse boards can rise to the challenges of a dynamic and often volatile commercial/political environment. Participants also claim that ignoring this critical requirement of present boards may be done at the cost of companies' sustainability. Not having ready access to a variety of inputs at the apex of the governance mechanism in companies (i.e. boards) may even result in their survival being threatened. It is also revealed by participants, especially board chairs and CEOs, that investors are carefully watching the composition of boards in companies before making their investment decision. A higher functional diversity on boards is taken by investors as a sign that merit is valued in those companies. Functional diversity on boards is interpreted by investors to be a sign of better CG and, thus, an assurance that their investment is secure and rewarding. Thus, diverse functional experience on boards seems to improve their signalling (Spence, 1973) role-effectiveness as well. Existing literature suggests that diversity on boards may communicate positive signals to stakeholders about the company providing an equal playing field (Fondas and Salsalos, 2000; Certo, 2003). The findings of this research suggest that in improving the signalling role-effectiveness of boards, functional diversity may have a significant role, and such signalling may be instrumental in companies getting higher investments.

While the findings do not in any manner indicate that boards in the FTSE 350 do not perform other roles (e.g. advise and counsel the executive), evidence was more readily made available by the participants about the functional diversity on boards managing dependencies and challenging managerial assumptions. These two aspects of board performance relate with resource-provisioning and monitoring/controlling roles. Further research with a larger sample set and a more detailed questionnaire may explore the extent of the impact of this attribute of diversity on boards' other roles.

Conclusion

Strategic leadership perspective suggests that corporate leaders in a firm are potentially its unique resource (Hoskisson *et al.*, 1999). Decision makers' education, professional experience and personal attributes may influence their actions and decisions (Hoskisson *et al.*, 1999). The findings of this study confirm the proposition of the theory, and further contribute to its application by indicating that a specific board capital – functional diversity of board members – impacts boards' effectiveness. The findings of the research further contribute to strategic leadership theory by describing how the diverse functional experience of board members may influence their perspectives and their actions, which, in turn, influence board effectiveness and CG. Functional diversity on boards enables them to have a range of skill-sets and other board capital while improving boards' access to networks and resources. The findings also posit that while a large body of research on board diversity is guided by theories arguing identity and network, strategic leadership theory may have a better fit to guide future research on the topic.

The findings of the study also contribute to agency theory, by indicating the boards with functional diversity may have enhanced skill-set and board capital, which improve their ability to challenge the executive on their assumptions, thus improving boards' monitoring role-effectiveness. As a result, functionally diverse boards may have improved boards' role-performance as shareholders' agents in aligning the interests of the executive with those of the shareholders (Fama and Jensen, 1983a, b). It is also observed that respondents seldom mention their role as "monitoring role" or that of "controlling the executive". Instead, the vocabulary used by the respondent is "challenging the assumption of the executives" which is improved when boards have diverse functional experience because it enables them to review executives' proposals more rigorously.

The study findings may also contribute to policy formulation and corporate practices because this research has presented the first-hand perspective of board members on one of the most relevant diversity attributes on boards to potentially improve their effectiveness. While this paper in no way claims that gender diversity or ethnic diversity on boards may not be relevant or less significant, it argues that boards need to define diversity broadly, and the composition of boards should be related to their role-effectiveness. Hence, the findings of this research may contribute to improved corporate practices, as companies endeavouring to promote their boards' effectiveness may be encouraged to look for other attributes of board diversity beyond gender and ethnicity. Board diversity is about building a board that accurately reflects the make-up of the population and stakeholders of the society where the company operates. Board diversity reflects the structure of society – the fact that we are now much more multicultural and diverse. The prior experience of the directors is shaped by “larger social structural context in which demographic differences are imbedded” (Hollowell, 2007, p. 51). The aim of board diversity is to cultivate a broad range of attributes and perspectives that reflects real-world demographics as boards need to continue to earn their “licence to operate in society” as organisations have a responsibility to multiple constituents and stakeholders, including the community and the wider society within which they exist. The goal of every business is profitability, sustainability and improving the overall well-being of society. Building social capital through diversity has value in the wider context of modern society and achieving social justice.

Participants in the study also reveal that in this era of potential regulatory intervention for promoting board diversity for improving corporate performance, companies are under pressure to engineer their board composition in order to satisfy the political and regulatory mandate/recommendation. However, board members feel that a superimposed board diversity, which has not grown organically and is not related to outcome, may be counterproductive for corporate performance and for individuals occupying those roles. The findings of the study suggest that boards may aim at breaking the norm of composing functionally homogenous boards and promote functional diversity, which will make boards more effective and also rid them of groupthink. The CG of listed companies is likely to benefit more from an output-oriented and strategy-driven board diversity, which is particularly more appropriate for the UK CG regime where historically companies do not appreciate regulatory/legal intervention (Goyal *et al.*, 2018). Such board composition may be welcomed by investors who are concerned about poor diversity on FTSE 350 boards (Makortoff, 2019).

Participants in the study also acknowledge that Chairs and CEOs still play a significantly influential role in board nominations and concede that the nomination process is not always as per the Code (2018), which recommends appointing board members with the help of independent agencies. However, if board members are recruited after an audit of its functional competence in order to remain optimally competitive, board composition may become more structured and objective.

While the paper makes several significant and unique contributions to the literature on board diversity, applicable theories, and praxis, it has a few limitations as well. First, the paper is based on a qualitative study carried out by interviewing a small sample of 42 board members of FTSE companies. In order to test the findings of the research, future studies may consider testing them on a larger sample using the quantitative technique of survey questionnaire. Second, as mentioned earlier, the purpose of this paper is not to evaluate the role of the more widely researched attributes of board diversity, such as gender and ethnic diversity, and hence these are not within the ambit of this paper. However, the findings of the research in no manner suggest that other attributes of board diversity may not be relevant in board effectiveness or CG. Third, the findings of the research suggest that attributes such as board members' parental status, religious beliefs and value-sets may also have a bearing on their perspective and decisions. However, those attributes are also kept out of the scope of this paper in the interest of parsimony and focus.

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